

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
300 Capitol Mall, Suite 1700
Sacramento, California 95814**

**File No. RH 394
August 21, 2001**

**SUBJECT: PROGRAM FOR THE INVESTIGATION AND PROSECUTION
OF AUTOMOBILE INSURANCE FRAUD**

FINAL STATEMENT OF REASONS

The Insurance Commissioner of the State of California (Commissioner) proposes to amend Subchapter 10, Article 4, Sections 2698.61, 2698.62, 2698.65, 2698.66 and 2698.67 of Title 10, Chapter 5 of the California Code of Regulations (CCR) regarding the program for investigation and prosecution of automobile insurance fraud. The purpose of the proposed adoption is to implement, interpret and make specific the provisions of the California Insurance Code (CIC) sections 1872.8 which requires the Commissioner to assess and distribute funds for the purpose of investigating and prosecuting automobile insurance fraud cases.

DESCRIPTION OF THE PUBLIC PROBLEM

The Insurance Commissioner of the State of California (Commissioner) proposes to amend Subchapter 9, Article 4, Sections 2698.61, 2698.62, 2698.65, 2698.66 and 2698.67 title 10, Chapter 5 of the California Code of Regulations (CCR) regarding the program for investigation and prosecution of automobile insurance fraud. The purpose of the proposed amendment is to implement, interpret and make specific the provisions of the California Insurance Code (CIC) sections 1872.8 which requires the Commissioner to assess and distribute certain funds to California district attorneys for the purpose of investigating and prosecuting automobile insurance fraud cases.

CIC section 12921 requires the Commissioner to enforce the provisions of the Insurance Code and other laws regulating the business of insurance in the State of California. The proposed adoption is necessary to implement, interpret and make specific the provisions of CIC section 1872.8. The proposed action would specify the level of annual assessment, the procedure by which district attorneys may apply for grant funding, the criteria and process by which the Commissioner will review and award grants and standards for reporting and auditing the grantees use of grant funds and performance under the grant program.

STATEMENT OF SPECIFIC PURPOSE

The specific purpose of each adoption, and the rationale for the determination that each adoption is reasonably necessary to carry out the purpose for which it is proposed, together with a description of the public problem, administrative requirement, or other condition or circumstance that each adoption is intended to address, is as follows:

Section 2698.61 Definitions

Amendments to this section would define and make clear the terms utilized in the grant program and to conform the terms of these regulations with those promulgated to implement CIC section 1874.8 (Title 10, CCR, sections 2698.70 et seq.)

Subsection (b) is amended to add a correct and specific definition of the term “assessment.” Subsection (h) is amended to make more specific the term “district attorney” by adding a reference to Government Code section 26500. Subsection (j) concerning the incidental expenses is deleted and replaced with a new subsection (j) which defines the term “Grantee”. Subsection (k) is amended to delete a reference to the Department of Industrial Relations and add a reference to the Department of California Highway Patrol and to district attorneys. Subsection (l) is deleted and replaced with a new subsection (l) which defines the term “insurer” by reference to California Insurance Code section 23. Subsection (n) is added to define the term “vehicle” as having the same meaning as that term is defined in Vehicle Code Section 670 and expressly stating that the term includes references to commercial and non-commercial vehicles.

Rational for Necessity: An amendment to subsection (b) is necessary to conform the existing text to that of the enabling statute. Subsection (h) is amended to make certain that the term district attorney does not include any other county office or officer. Subsection (j) was deleted so as to assure no duplication with existing statutory language and regulatory provisions. A new subsection (j) is added to provide a uniform definition of the term “grantee” as used in this article and distinguish it from other terms used in these regulations. Subsection (k) was amended to delete an erroneous reference in the existing regulation to the Department of Industrial Relations and to add a correct and complete reference of the entities who may be recipients of program fund distributions, specifically, the Department of California Highway Patrol and district attorneys. Subsection (l) was deleted because it was deemed unnecessary and was replaced with the new subsection (l) which makes clear and specific the term “insurer”. Subsection (n) was added to make clear and specific the meaning of vehicle as used in this article which is otherwise defined differently through other areas of statutory and case law and further amended by a post notice change to make clear that the term vehicle includes both commercial and non-commercial vehicles.

Section 2698.62 Annual Fee

Specific Purpose: Existing subsection (a) is deleted and replaced with a new subsection (a) which maintains the existing assessment amount of one-dollar (\$1.00) and provides a clear and specific method for the assessment as set forth in statute. The proposed new subsection provided that insurers may not prorate the assessment either in the amount assessed or the payment. After the receipt of public comments and by supplemental notice, the proposed new subsection (a) was modified to allow insurers to “annualize” their payment of the assessment over the period of the year in quarterly increments. This modification deleted the express prohibitions against prorating of the amount and the payment.

A subsection (b) is added to establish a methodology for calculating the assessment and a requirement that insurers report, under penalty of perjury, the number of vehicles subject to assessment.

Subsection (c) makes certain specific exceptions to the assessment methodology.

Subsection (d) is added to establish the legal requirement that assessments not paid within forty-five (45) days of the invoice date will be considered delinquent and will incur a late fee.

Subsection (e) was added to allow the Commissioner, within the limits otherwise applicable under Insurance Code 1872.8 and this section, to conform the overall amount to be collected through this assessment so as not to exceed the maximum amount of program expenditures authorized by the annual State budget act.

Rational for Necessity: CIC Section 1872.8 and existing title 10, CCR, 2698.62, requires insurers doing business in this state to pay an annual assessment of one-dollar for each vehicle insured under an insurance policy it issues in this state in order to fund the investigation and prosecution of fraudulent automobile insurance claims and economic automobile theft. Neither CIC section 1872.8 nor existing regulation specifies an exact method for establishing and collecting the assessment. The assessment undertaken under the existing regulations have resulted in unintended interpretations being used by some insurers who have used the lack of specificity to employ various and inconsistent assessment methods and definitions of the term vehicle. After review of public comment, it was determined that a more fair and accurate manner of assessment would be to allow insurers to pay the \$1.00 assessment on an annualized basis. Because these further amendments would result in a limited amount of prorating where the vehicle is not insured during every quarter of the year, subsection (a) was also amended to delete the existing prohibition against the prorating of the amount or payment of the assessment.

Subsection (b) was added to provide a specific and clear method for insurers to calculate and pay the assessments required under this section. A further amendment was needed to delete existing proposed language that would require 100 percent of the assessment to be paid for each vehicle as it came under a policy and to add text that would make specific

the method to be used by insurers in calculating and paying the assessment under this section.

Subsection (c) (1) is necessary to prevent an interpretation of the regulations which, while allowing for the broadest range of assessment consistent with the enabling statute, would preclude the same insurer from being assessed more than once for the same vehicle during the same quarter. Subsection (c)(2) is necessary to exempt possible duplicate assessments by excluding policies that are considered secondary to a primary policy and that pose a rather low risk of any fraudulent activity.

Section 1872.8 does not provide a time period within which the assessment must be paid. This new section establishes a delinquency period and an appropriate sanction for late payment. CIC 12995 is used by the department to assess late charges in other areas. Subsection (d) is necessary to make specific the time period for submission of assessments and provide sanction for delinquency.

Subsection (e) was deemed necessary to avoid an unanticipated accumulation of assessment revenue that can not be expended under the program due during a given fiscal year. No other available method has been ascertained that would more effectively respond to this concern.

Section 2698.65 County Plan and Criteria for Distribution of Funds to the Grantees

The amendments to this section make more specific the criteria for the determination and distribution of the grant award. Subsection (3)(A) has been amended to add as a criterion a description of the manner in which it will develop its caseload in coordination with other participating and related entities. Non-substantive amendments were made to the title of the subsection by striking the terms “District Attorneys” and to subdivision (b) by striking the term “countys” and adding the term “applicant.”

Rational for Necessity:

CIC 1872.8, subsection (b) (1)(D) provides in pertinent part, that the applicant counties shall submit such other relevant data as the Commissioner may require. With this amendment the Commissioner recognizes that the grantee’s willingness and ability to coordinate with other law enforcement agencies is an essential component of any effective program directed at the investigation and elimination of automobile insurance fraud. The non-substantive changes were needed to maintain uniformity in the text of the regulations.

Section 2698.66 Budget Proposal

Specific Purpose: The amendments to this section delete existing subsection (c) and add in its place a new subsection (c) which provides a uniform guideline for the determination of and a cap on indirect costs. Subsection (d) has been amended to make specific that the allowable costs for food and beverages can not exceed the costs otherwise allowable

under the grantee's per diem schedule. Subsection (f) provides a general requirement that proposed budgets may be modified so long as they do not change the overall grant award amount.

Rational for Necessity:

CIC section 1872.8, subsection (b)(1) requires that each applicant for a grant provide a detailed statement of the proposed use of any monies as well as a detailed accounting of the monies received in prior grant periods. This subsection further provides that the Commissioner shall undertake a fiscal audit of the programs at least once every three years.

The existing regulation allowed and resulted in a non-uniform system of budgeting, accounting and reporting. The amendment to subsection (c) will provide a uniform basis for preparing a budget and for reporting which will also facilitate fiscal auditing of the program.

Subsection (d) is necessary to make specific the criteria that the Commissioner deems to be allowable costs for food and beverages.

Finally, subsection (f) is necessary in order to allow for a procedure for modification of the proposed budget after submission to the Commissioner.

Section 2698.67 Grant Reporting and Audit and Commissioner's Audit

Specific Purpose: The opening paragraph is amended to delete any unnecessary and non-specific language.

A new Subsection (c) is added which provides a standard for the uniform reporting and auditing of the program fiscal activity. The standard adopted by incorporation is that of the Government Auditing Standards (Revised July 1999). This subsection further establishes a requirement that the grantees cooperate with the Commissioner in the undertaking of any audits and provides sanction for a grantee's refusal to cooperate.

Subsections (c)(d)(e) and (f) are re-lettered to subsections (d)(e)(f) and (g) accordingly.

Rational for Necessity: The use of the phrase "at a minimum" is unnecessary and nonspecific in that it denotes other non-specific requirements may exist. This amendment deletes the existing subsection (c) and replaces it with a new subsection (c) which replaces a less specific and non-uniform method of reporting and auditing program costs and replaces it with an established standard auditing methodology and format to be used in performing these audits. This section brings these provisions into conformity with a similar audit procedure established for similar audits to be performed under the Organized Automobile Insurance Fraud Program (tit.10, CCR, section 2698.70 et seq.) CIC section 1872.8, subsection (b)(1) requires that the Commissioner perform a fiscal audit of the each grantee's program at least once every three years.

DETERMINATIONS

ALTERNATIVES

These regulations are being amended to make more specific and clear both the provisions of the enabling statute and existing regulatory scheme as well as to conform the provisions of this assessment program to a related but distinct existing assessment program. Subsequent to the original notice amendments and in part in response to alternatives suggested by the comments received and in part based on the Department's experience with a similar but separate assessment process, the Commissioner noticed changes to the proposed regulations as originally noticed. Specifically, the changes allow the insurers to annualize the payment of the assessment as well as make some related technical changes identified by the Department.

COST OR SAVINGS AND MANDATE TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The California Department of Insurance has determined that there will be not impose a mandate upon local agencies or school districts, nor are there any costs for which reimbursement is required by Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

MATERIAL INCORPORATED BY REFERENCE

Government Auditing Standards (Revised July 1999) published by the Comptroller General of the United States, General Accounting Office. This document is maintained and can be viewed on the Internet at <http://www.gao.gov>. Once at the homepage for the Government Accounting Office, further reference should be made through "other publications" to "complete listing" and then "Government Auditing Standards."

SUMMARY OF AND RESPONSE TO PUBLIC COMMENTS

In response to the comments received as a result of the Notice of Proposed Rulemaking issued on October 27, 2000 and at the public hearing held on December 15, 2000 the Department of Insurance (DOI) submits the following responses.

The DOI issue a Notice of Changed Text on 2000 June 25, 2001. However, No comments were submitted to that notice.

Section 2698.62 SETTING OF ANNUAL FEE

To the extent that the proposed regulations preclude proration of the assessment, they are inconsistent with or authorized by enabling statute.

Comment No. 1:

National Association of Independent Insurers (NAII)

“To the extent that the provisions of this section prohibit consideration of the length of time that a vehicle is covered under a policy of insurance it is inconsistent with the enabling statutory language in Insurance Code section 1872.8.”

(Hearing Transcript (HT) page 7, Ll. 3-23.)

NAII

“The assessment calculation method in the proposed amendments to Section 2698.2 would prohibit prorating assessments and would require an auto insurer to pay one dollar assessment whenever a policy of insurance is issued for a vehicle. This method would create situations where the one-dollar assessment is paid more than once during the course of a year for a particular vehicle. This is not what the Legislature intended when it passed Insurance Code Section 1872.8.”

(NAII – Letter (Ltr) - December 15, 2000)

Association of California Insurance Companies (ACIC)

“The proposed regulation fails to meet the ‘authority’ criterion set forth in Gov. Code 11139.1(a)(2), and should be rewritten to satisfy that requirement. Where the ‘annual’ fee is assessed against a vehicle insurance policy with less than a one-year duration, the proration of that fee must be allowed by the department in any regulation intended to implement the authority granted by Insurance Code 1872.8.”

(ACIC Ltr - December 8, 2000)

Personnel Insurance Federation of California (PIFC)

“PIFC objects to the proposed amendments contained in Section 2698.62. The new methodology proposed in Section 2698.62 for calculating the annual fee assessment results in an annual assessment in excess of what is allowed for by the statute. Thus the new methodology proposed in Section 2698.62 violates the standard of authority set forth in Government Code Sections 11342.1 and 11349(b).”

(PIFC Ltr - December 7, 2000, page 1)

PIFC

“The proposed amendments to Section 2698.62(a) state in pertinent part that neither the amounts nor the payment of the assessment shall be prorated. This, in conjunction with Section 2698.62 (b), which requires that the first quarter assessment be calculated by identifying the number of vehicles in this state for which a policy of insurance in force as of January 1, plus the number of vehicles for which a new policy has been issued in the first quarter, appears to permit an annual assessment per vehicle in excess of the \$1 allowed under Insurance Code Section 1872.8.”

(PIFC Ltr - December 7, 2000, pages 2-3)

PIFC

“We believe that the methodology proposed for calculating the fee is in excess of what is allowed under state and it is beyond the scope of authority granted to the department by the statute and therefore invalid. The clear intent, we believe, both looking at the express language of the statute as well as the legislative history of Insurance Code Sections 1872.8, which has been in existence since 1989, is to allow for an annual maximum assessment of one dollar per vehicle to go to the insurance fund for increased investigation and prosecution of fraud, and were concerned that the methodology proposed in the amendments to the regulation would allow an annual assessment per vehicle in excess of that dollar allowed for under the current law.”

(HT: Page 15, Ll. 21 – Page 17, Line 24.)

DOI’s Response:

These comments interpret the statutory provision, of Insurance Code section 1872.8, subdivision (a), as restricting the assessment to one-dollar per vehicle per calendar year. The DOI believes that by disregarding the number of policies or the number of insurers who may have issued those policies on a particular vehicle, this interpretation itself is not consistent with the full statutory language which provides for an assessment to be paid from “each insurer doing business in this state.. for each vehicle insured under an insurance policy it issues in this state.” This provision requires that an assessment be made by (1) each insurer, (2) for each vehicle, (3) it issues a policy of insurance. The DOI believes that the original proposed amended text was consistent with the statutory language. However, the DOI agrees that the proposed amended text as originally proposed is not the only possible approach consistent with the statutory provision.

Due in part to the concerns expressed in this and other comments, as well as a need to obtain more flexible in the collection of the assessment, the DOI has further changed the proposed amended text as originally noticed to provide for the payment of the one-dollar assessment to be made on an annualized basis. This approach maintains the assessment level at one-dollar per vehicle; but permits the calculation and payment of the assessment on a quarterly basis. This approach would permit a degree of prorating but would eliminate any concern that an insurer would be required to pay more than one-dollar on a particular vehicle during a given year.

Comment No. 2:

Absent a change the provision of the enabling statute, the Department may not amend its regulation to prohibit prating of the assessment..

NAII

“In the absence of any change to the assessment provisions of Insurance Code 1872.8 [since the extant regulations were promulgated], the Department of insurance may not now amend them to prohibit proration of the assessments.”

(NAII Ltr - December 15, 2000)

DOI's Response:

The extant regulations do not address the issue of whether an insurer may prorate either the annual fee either in its amount or in payment. An express purpose of the proposed amendments is to make more specific the extant statutory and regulatory provisions concerning the calculation and payment of this assessment.

Comment No. 3:

To the extent that the regulation prohibits prating of the assessment, it is unfair to insurers of policies with terms less than a full year.

NAII

To the extent that the provisions of this section prohibit consideration of the length of time that a vehicle is covered under a policy of insurance it imposes an inequitable burden on non-standard and other short term insurers and the insured.

(HT - Page 8, Line 4 – Page 12, Line 17)

“The amendments to section 2698.62 would require nonstandard insurers to pay an inordinate and inequitable share of the costs of California’s auto insurance fraud programs. Because nonstandard insurers’ book of business are fluid, nonstandard insurers would have to pay the full one dollar assessment time and time again over the course of a calendar year. In contrast, insurers with stable books by business would pay relatively fewer assessments.”

(NAII Ltr dated December 15, 2000 page 6)

DOI's Response:

The DOI does not believe that the proposed amendments as originally imposed an inequitable burden on non-standard or other short term insurers. Insurers under the proposed amendments as originally noticed were to be assessed based on the number of vehicles on which they had issued policies regardless of the duration of the policy. However, for the reasons stated in the DOI’s response to comment number 1, the proposed amended text originally noticed has been changed. These changes, among other things, permit insurers to calculate and pay the annual assessment on a quarterly basis. Under this approach, an insurer who has issued a short term policy will be assessed and pay the same quarterly assessment as an insurer who has issued a policy covering a full year.

Comment No. 4:

Several commentators suggested that due to the types of lines of insurance they write or the manner they internally track the vehicle policies, it is difficult or impossible to

undertake a vehicle-specific or “hard” count for the purpose of determining the proper amount of assessment. Some commentators suggested an alternative means of counting the vehicles to be used (i.e., “car years”.)

NAII

“The one [alternative] we would suggest is written car years. The written car ears approach has an accepted actuarial meaning. It seems to be just as effective in providing the specificity that the department is looking for, and it’s also a method that the department’s already using. The CARP, California Automobile Risk Plan, manual specified that assessments are made based on written car years and that seem to work.

I know in the written material there was concern about companies adopting different methods and perhaps some suggestion that companies are not paying what they should be paying. I think there is a way to remedy that. I think the section could be redrafted to specify the written car years approach, and the department I think is free to audit companies to make sure that they’re complying with those requirements.”

(HT - Page 13, Ll. 3- 18.)

DOI’s Response:

These regulations do not require a specific method that every insurer with every line of insurance must use to count the number of vehicles on which they have issued a policy insurance during the assessment period. However, these regulations do require each insurer to certify, under penalty of perjury, that the number of vehicles reported for the assessment period is accurate. So long as the count is accurate and verifiable, these regulations do not dictate a method that the insurer must use in counting the vehicles.

Although these regulations do not require insurers to maintain records reflecting a “hard count” of every vehicle on which a policy of insurance has been issued, the DOI believes that such a system is either already or can be maintained by every insurer. The DOI also believes that where an insurer is capable of or is currently using a system of “hard counting” that such system is the most accurate and fair method of counting. The DOI will promulgate further provisions to address this issue should it be deemed necessary.

Comment No. 5:

To the extent that the proposed regulations prohibit insurers from prorating their assessment, they result in a new cost to insurers.

NAII

“The proposed amendments to Section 2698.62 would impose new costs on the businesses that are required to pay the fraud assessment. The existing regulation allows insurers to prorate the annual one-dollar assessment. The proposed amendments would prohibit proration. Without the ability to prorate, the assessments paid by some insurers could double, triple, or even go beyond tripling. These would be new costs for insurance businesses that are currently serving California consumers.”

(NAII Ltr - December 15, 2000 pages 7-8)

DOI's Response:

The DOI disagrees with the assertion that the existing regulations allowed insurers to prorate the annual one-dollar assessment. The existing regulation do not specifically address the methodology to be used by insurers in calculating the assessment under Insurance Code section 1872.8, subdivision (a). The extent regulations merely specify articulate the statutory requirement that insurers must pay an annual assessment of one-dollar on every vehicle which they have issued a policy of insurance in this state. Since the proposed regulation merely serve to clarify an existing statutory requirement, the DOI does not believe that the proposed regulation impose a new costs on insurers doing business in this state. In part, due to the apparent inconsistent interpretation of these statutory requirements by some insurers, the extant amendments to the regulations are necessary.

However, the DOI has considered this and other comments to these regulations and does agree that there is a possibility that under the amendments originally noticed a single insurer might be subject to multiple one-dollar assessments for the same vehicle it has issued a policy of insurance on in this state for the same assessment period. Accordingly, DOI did notice a change to the proposed amendments originally noticed. These changes permit the calculation and payment of the assessment on a quarterly basis. This method would permit insurers to pay the assessment based on a count of the vehicles on which a policy of insurance has been issued during a specific quarter. This change would be responsive to this comments.

Comment No. 6:

To the extent that the proposed regulations prohibit prorating of the assessment, the regulations are not necessary.

NAII

“The Department of Insurance’s Initial Statement of Reasons notes that the amendments to Section 2692.62 are necessary because the existing regulation fails to specify ‘an exact method for establishing and collecting of the assessment.’ The amendments’ response to this lack of specificity is the proposed prohibition against prorating. However, a ban on prorating is not necessary to establish specificity.”

(NAII, Ltr - December 15, 2000, page 8)

DOI Responses:

This comment is directed solely at the particular method chosen rather than the necessity for a regulation making the statutory provision more specific. However, the DOI has further amended the proposed regulation at which this comment is directed. This further amendment responds to this comment.

Comment No. 7:

The proposed amendments fail to consider other alternatives.

NAII

“NAII believes the ‘written care years’ methodology should have been considered as an alternative to the prohibition against prorating.”

(NAII, Ltr - December 15, 2000, page 8)

PIFC

“We also believe there are alternatives and we’d like to suggest three. One, the most obvious is just to strike the addition of that sentence that precludes proration. We think also the result could be ameliorated to some degree by clarifying what the department intends with the prohibition against proration contained in that section. In other words, is the quarterly assessment based upon an anticipated maximum assessment of one dollar per vehicle per annum with the amount due being subject to a quarter percentage of the whole? Under these terms, the quarterly assessment, although paid on a quarterly basis, could be based upon a maximum annual assessment of a dollar and would eliminate the overpayment. ...As a third alternative, we would recommend that CDI look at ways to establish a better mechanism for tracking payment of the fraud assessment by companies who may currently fail to comply with the statute.”

(HT - Page 15, Ll. 21 – Page 17, Line 24)

DOI’s Response:

The DOI, in part responding to these suggested alternatives, has noticed changes to the amended regulations originally noticed. These changes would, among other things, provide for a method of paying an annualized assessment that would permit insurers to pay calculate and pay the assessment on a quarterly basis. The DOI has struck the express provision prohibiting proration.

CALIFORNIA DEPARTMENT OF INSURANCE

DICK ROSS

Deputy Insurance Commissioner